A REPORT BY THE SECTOR TASK FORCE ON

THE CANADIAN AUTOMOTIVE INDUSTRY

Chairman Norman H. Bell

AUTOMOTIVE CONSULTATIVE TASK FORCE

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PREAMBLE

The Task Force on the Automotive Industry, which represents vehicle manufacturers, multinational and Canadian independent parts producers, labour, academics and government, brought together a group of individuals who have widely differing perspectives on the issues currently facing the automotive industry in Canada.

The early meetings of the Task Force were held at a time when there was increasing public debate on the merits of the Canada-U.S. Automotive Products Agreement,a growing concern that Canada, with a rising deficit in world trade in automotive products, was not attracting enough new investment to improve the balance between production and consumption and that companies and government alike were not moving to correct the situation.

Before attempting to find solutions, it became necessary to understand from these various perspectives, the true nature of the factors which resulted in a trade deficit in automotive products with all countries of $1.2 billion in 1977.

The Task Force members came to the realization that the issues were complex and that there was an interdependency between many of the issues. There was a growing realization that to resolve the issues would require consideration of matters beyond the terms of reference of the Task Force members.

The federal government, via another route, obviously arrived at similar conclusions resulting in the appointment of a special adviser under the Inquiries Act in the person of Mr. S.S. Reisman to submit, by the end of October 1978, a report for consideration by the government on the development of an internationally competitive Canadian automotive industry.

With this appointment being made before the report of the Task Force was completed, it was decided that the most significant contribution which could now be made by the Task Force would be to lay before government the facts as seen by the members, to identify areas of general concern and to present some of the options open for achieving a better balance between automotive production and consumption in Canada.

1.0 OBJECTIVE

To supplement the industry sector profile by the addition of an industry perspective;

To identify factors inhibiting the growth and development of the automotive industry in Canada; and

To define some of the options which could lead to a better balance between production and consumption in Canada and in its worldwide automotive trade.

2.0 INDUSTRY AND MARKET SUMMARY

2.1 General

The Canadian market for motor vehicles and parts, both original equipment and aftermarket had a factory cost in excess of $7 billion in 1977.

The automotive industry consists of both vehicle assembly and parts manufacturing. Parts are manufactured both by vehicle manufacturers (captive) and by independent parts companies. The market for parts is broken down into two categories namely Original Equipment and Aftermarket. The aftermarket for parts is roughly 10 per cent of the value of the new vehicle market.

The trade deficit with all countries in automotive products in 1977 was $1.2 billion. This deficit is made up of distinct segments that relate to original equipment, either of North American vehicle manufacturing origin, or third country vehicle manufacturing origin and aftermarket parts, tires and miscellaneous items included in general automotive statistics.

In dollar terms in 1977, the North American vehicle manufacturers' deficit was in the order of $250 million with aftermarket, etc., at $200 million while third country manufacturers were responsible for $650 million deficit with aftermarket at $100 million.

2.2 North American Rationalization

The industry in Canada is part of a rationalized integrated North American industry. It grew into its present form following the introduction of the Canada-U.S. Automotive Products Agreement. The manufacturing activity has been influenced by the ratio and CVA requirements that were included in the automotive agreement and by the generally favourable economic climate of the 1960's. These influences have led to an imbalance in manufacturing activity with an excess of vehicle assembly and labour-intensive operations and less high technology capital-intensive parts manufacture.

Rationalization of production, since the inception of the Automotive Agreement has effectively increased the total trade with the U.S. This rationalization has tended to make the majority of vehicle assemblers and parts manufacturers in Canada a supplier industry to the vehicle companies in the U.S.

2.3 Industry Structure

The industry is predominantly U.S. owned. Rationalization and the need to maximize efficiencies have led to a consolidation of many of the decision-making functions into the U.S. It is important to note that while this is generally true, there are some exceptions and these are automotive parts companies operating in Canada that have unique product lines.

2.4 Industry Performance

During the late 1960's, when Canada had advantages as a location for new investment, and the industry was required to meet certain growth commitments under the Automotive Agreement, the Canadian vehicle assemblers and parts producers increased their share of North American automotive production. Since 1971, the industry appears to have retained this share of production, not necessarily balanced between parts and assembly, but with growth being in line with the overall growth of the North American market.

The industry is one of the most efficient in Canada. It is internationally price competitive, profitable, operating near capacity and growing. Employment in the industry in 1978 is reported to be at record levels.

2.5 Market

The Canadian new vehicle market in 1977 was as follows:

797,752	North American Type Cars
337,901	North American Type Commercial Vehicles
193,646	Other Cars
15,647	Other Commercial Vehicles
1,344,946	Total Units

Vehicle sales in Canada have been increasing at a faster rate than in the U.S. In the period 1965-1976, sales increased at an average rate of 3.7 per cent in the U.S. and 5.4 per cent in Canada. Because total production in vehicle assembly and parts in Canada has been tied to growth in the North American vehicle market as a whole, it means that total production in Canada has not kept pace with demand in Canada.

3.0 ISSUES

3.1 National Perspective

Vehicle assembly and auto parts manufacturing are desirable activities that are well suited to a developed economy and are considered likely to have a healthy long-term future because of advanced technology, high volumes and high productivity.

With a sizeable trade deficit in the automotive sector, Canada must seek ways of increasing its share of production to reduce the adverse effects on investment, employment, growth of the industry, etc.

3.2 Corporate Perspective

Decision centres affecting the majority of Canadian production are located in the U.S. These decision centres have a continental or worldwide perspective. Moves within the industry towards a "world car" require centralized decision making in order to reap the maximum benefit from this concept. Local autonomy by subsidiary companies is generally limited and is not determined by the performance of the subsidiary or the economic climate in the country of the subsidiary. Local manufacture is, however, influenced by these factors and by government legislation.

The investment climate in Canada, as seen by the non-resident decision maker, has a number of disadvantages and risks although there are also a number of advantages. In those cases where there is any economic advantage, it is generally considered to be insufficient to overcome this perception. Canadian subsidiaries are, in the overall, profitable. They are not perceived as presenting any major problem to their parents but neither are they perceived as presenting significant opportunity. It is hoped that the Canadian government will work to improve the Canadian business climate.

Canadian independents with complete autonomy are faced with a different set of problems in competing in the U.S. where they are viewed as foreign corporations. They feel they must overcome buyer preferences for domestic producers and reluctance to sole source in Canada even where there is a unique capability.

3.3 The Issue

The corporations which make up the industry in Canada do not appear to have a problem at this time in that they are profitable and working close to capacity. This would support the contention that Canada can be a desirable and economic location for automotive production. There is, however, a national problem with the growing gap between automotive production and consumption in Canada where some action must be taken.

3.4 Dimensions of the Issue

The Canadian share of the North American automotive market is increasing and there are those who are committed to a concept of "fair share" which they define as a balance between production and consumption. There still remains a question whether it is appropriate for Canada to seek a balance in a specific sector such as automotive trade. To obtain a "fair share" would require that Canada capture an increasing share of North American automotive production.

There is a further question of how far "fair share" should be carried. Does it, for example, extend to employment, R&D, particular types of automotive activity? There is an imbalance within the industry and this imbalance leads to a degree of vulnerability and could well inhibit Canada's ability to attain a "fair share". Some of the areas of imbalance have been identified as follows:

- Too few decision centres (investment, R&D, purchasing, marketing).
- A high proportion of labour-intensive work.
- A deficiency of capital-intensive (high technology) work.

Automotive manufacturing is concentrated primarily in Southern Ontario while automotive products are consumed all across Canada. This activity is at least as desirable for Quebec and Manitoba, for example, as it is for Canada as a whole. While it may be a legitimate provincial objective to aspire to "fair share", there are obvious limitations to the extent to which such aspirations can be accommodated across the country.

The North American automotive industry has entered a period of massive technological change to meet government mandated fuel economy, safety and emission standards. This change brings with it the need for unprecedented

investment in all sectors of the industry with the majority of the investment devoted to the retooling of existing plants. In some instances, it could have the effect of increasing their capacity. Some investment will be devoted to new, lighter-weight products and the principal opportunity for Canada to increase its share of North American automotive production would appear to lie in attracting investment in these new products where favourable conditions exist in energy and material availability. Decisions on location of production of these products will be made in the near future. Once this program is completed little additional investment is foreseen for several years. The opportunity to increase the Canadian share of production is therefore immediate.

The deficiency of automotive production in Canada is not solely related to the Automotive Agreement and should take note of all of the areas in the industry where there is a deficit in trade including third countries and aftermarket.

4.0 BACKGROUND/CONSIDERATIONS

4.1 General

The industry sector profile was the basis for much of the discussion at Task Force meetings. Although there was no consensus on the statistical data used in the profile, the general conclusions were acceptable and have been expanded upon in this report.

Members of the Task Force raised a number of issues many of which were dealt with individually, although it was clearly understood that there was an interdependency between them. Members suggested a wide variety of solutions and there was not always a consensus. No attempt has been made to place the subject areas covered in this section in any order of priority.

4.2 Investment Climate

Foreign investors, both parent and independent corporations, generally perceive the Canadian climate as being uncomfortable. While the Task Force did not undertake a detailed analysis of locational costs for Canada and the U.S., it is the view of many companies and the UAW in Canada that this perception is a misperception. Indeed, in terms of facility operating costs, it was reported that there are definite advantages to a Canadian location. The foreign perception is that Canadian governments are seen as having gone too far, too fast, in social legislation. This is seen as having weakened the work ethic and resulted in labour instability. Other elements are seen as high inflation and a volatile exchange rate. The uncertainty surrounding Canadian federation leads to a feeling that investment in Canada is high risk investment. Government intervention in industry affairs is not welcome. The AIB rules have tied income over a year period to a base year in which profit performance was unsatisfactory. Simply the existence of a FIRA is seen as evidence of a lack of desire for foreign investment. The possibility of government takeovers of industry contributes to the general uncertainty. On a more concrete plane elements such as taxes on the means of production (sales taxes on building materials and non-production machinery and equipment) or regulations that affect plant utilization in the context of its effect on Canada's industries' ability to compete internationally are decided headwinds. In a similar category, the personal income tax system in Canada makes it extremely difficult to transfer specialist skills to Canada without incurring exorbitant penalties.

Canadian independent parts producers pointed out the highly competitive investment climate in the U.S. which stems from the ability of U.S. states to offer substantial incentives in a variety of forms. They pointed out that investment in Canada is discouraged by factors such as high interest rates, the lack of availability of skilled tradesmen, the risk involved in acquiring tooling without long-term purchasing commitments and a general lack of interest on the part of financial institutions to support these producers.

4.3 Investment Economics

Insofar as original equipment parts production is concerned, companies both Canadian independent and multinational are, in the main, free to invest on either

side of the Canada/U.S. border. Location decisions are thus governed by normal commercial motivation, although the negative factors mentioned in 4.2 may tend to result in U.S. based decision makers looking for a somewhat higher return on investment in Canada.

There is an international boundary between the U.S. and Canada. While the flow of goods has been materially expedited, there are continuing duties and administration costs. There are separate U.S. and Canadian currencies that do fluctuate in value relative to one another and currency fluctuations can affect the profit of a corporation. These factors, together with others, would lead a decision maker to locate production where their impact would be minimal.

The current exchange rate at current wage levels does give Canada a labour cost advantage which assists in generating higher returns. Higher sales taxes on building materials and non-production machinery and equipment tend to have the opposite effect. The availability of low interest rate revenue bond financing in the U.S. combined with generally higher interest rates in Canada than in the U.S. works against Canadian interests. Incentives offered by U.S. states and municipalities have a similar effect.

The U.S. has a complete range of vehicle assembly and parts production facilities. Canada does not. In many instances, these facilities are capable of accommodating expansion and almost without exception, it is more economic to expand an existing facility than it is to erect a new one. In situations in which expanded capacity is required, there will be many instances where it would not make economic sense to even consider Canada.

4.4 Industry Structure

Independent parts manufacture accounts for close to one-half of automotive value-added in Canada. The Big Three are customers for about 90 per cent of the original equipment output. There is a feeling within the parts industry that when having to sell into the U.S., Canadian companies are at a disadvantage even if competitive with U.S. suppliers and they point to the lack of decision centres in Canada in purchasing and new product development as being major factors. Vehicle companies, on the other hand, point out that (a) many Canadian parts manufacturers are not aggressive in seeking business, and (b) several of the larger parts manufacturers in Canada rely on the sales organization of their U.S. parent and commitments cannot be extracted to locate production of a specific order in Canada.

4.5 Technological Change

The North American automotive industry has entered a period of unprecedented technological change to meet government mandated fuel economy, emission and safety standards. Within the vehicle companies, every major plant will require to be retooled, at least once, to produce the new lighter-weight, more efficient vehicles and components for them.

While the majority of investment in the 1978-1985 period will be devoted to retooling existing assembly and parts plants, there will be a proportion that will go into new plants to produce new technology components, e.g. aluminum castings and plastic components. Decisions on the location of these new plants will be made in the near future. Once these decisions have been made, it is unlikely that there will be much more investment opportunity until well into the 1980's.

The opportunities for new plants to manufacture new products are accompanied by the demise of old products. Canadian parts and vehicle manufacturers must pursue these opportunities aggressively not just to maintain but to improve their share of the market.

4.6 Third Country Considerations

Prices of third country manufactured vehicles have not increased in proportion of the currency revaluations that have taken place in recent years. Comparative

prices between Canada and the U.S. indicate that third country vehicle manufacturers are absorbing a high proportion of the Canadian customs tariff. These manufacturers are protecting their share of the North American market. It would appear logical for them to consider locating production for the North American market in North America. Volkswagen has already established a production facility in the U.S.

Canada could have certain attractions to these third country manufacturers as they are located in "energy-short" countries, whereas Canada has energy in relative abundance. It could make sense for the Japanese to have aluminum components cast at Kitimat. An arrangement in which components were supplied to Japan (or Europe) in return for cars supplied from the U.S. is not beyond comprehension.

The North American based vehicle companies are moving towards world vehicles. It would be theoretically possible for one country to produce all of the engines and another all of the shock absorbers. While this will not happen, there will be a move towards greater international specialization which will increasingly require Canada to view automotive production in a world rather than a continental context.

4.7 Research and Development

Research and development in the automotive industry is largely a development activity relating to vehicle design and performance criteria. Through research and development, production benefits are realized with the introduction of new materials or equipment, the consumer benefits, and legislative requirements are met.

The North American vehicle companies and many of the major parts producers have a presence in many countries around the world. They have found it economic to centralize much of their engineering and research and development at corporate headquarters. With the trend to world vehicles and world standardization of components some have found that it has become even more imperative that the engineering function be centralized.

Within certain companies, a policy of product specialization between plants is followed. In these instances, research and development is often performed at the plant level with the downstream results being realized in the plant at which the research and development is being performed. It is this type of research and development which Canada should be aggressively seeking.

Concern was expressed over the lack of commitment by the Canadian government to research and development pointing in particular to the withdrawal of support programs and then their subsequent reinstatement. A more fundamental problem was identified as being a shortage of qualified specialists to perform the research and development functions in Canada and the lack of linkage to the academic community. The fact that research and development by the vehicle manufacturers is largely centralized in the U.S. is seen as a further deterrent to growth in this area by the parts producers.

4.8 Manpower

In Section 3.4, it was stated that Canada had a greater proportion of labour-intensive work and a deficiency in the high technology areas of the industry. In addressing this fact, it was identified that there is an increasing need for skilled trade people as new technologies are introduced into the automotive industry. The requirements for new and updated skills will accelerate, necessitating a closer liaison between industry and government educational authorities. Training and apprenticeship programs that more precisely meet the need of the industry will have to be implemented.

Productivity in the industry has been increasing at a greater rate in Canada than in the U.S. While it must be acknowledged that productivity measurement from available statistics is at best imprecise there are indications that some plants, both assembly and parts, are extremely efficient by generally accepted North American standards. On a combined labour rate/productivity index, Canada enjoys some advantage over Northern U.S. locations. If Canada does not share in the impact of the technological change both in production and product, then it will lose this advantage.

It was recognized that the re-equipping of existing assembly and parts plants will, in some cases, result in some manpower dislocations. Although it is too early to accurately assess the full impact, it appears likely that total employment in the industry in North America will decline by 1985 in spite of increased output. The government should consider some form of transitional assistance benefit to ease the burden on the worker who may be displaced in Canada. It should also be realized that there will be considerable dislocation in the industry in the process of change and benefit would be applicable in this situation as well.

5.0 RECOMMENDATIONS

Recognizing the appointment of Mr. S.S. Reisman as Special Adviser on the Automotive Industry, the Task Force recommendations are confined to those items which do not impinge on his mandate. As an alternative to recommendations, a decision was made to present various options which could contribute to the work of the special adviser. These are covered in Section 6.0.

5.1 Annual Report

The government should prepare a report on the performance of the industry and submit it to Parliament on an annual basis. This report would review developments in the previous year covering trade, production, sales, investment, employment, the Automotive Agreement and related matters.

5.2 Investment Climate

The government should take action to improve the investment climate in Canada to create an environment that is attractive to new automotive investment. The impediments to investment are as outlined in Section 4.2.

6.0 OPTIONS

Although the Task Force has recommended that the government take action to improve the investment climate, it recognizes that this is a long-term proposition. Major investment decisions will be being made in the near future and some more immediate action is required.

The extremes of action which would appear to be open to governments are:

- The provision of investment incentives which would make Canada compellingly attractive.
- The denial of access to the Canadian market unless Canadian investments are made.

It is appreciated that governments might have difficulty singling out one particular industry for this special treatment. On the other hand, the time-scale for investment decision making in the automotive industry demands that it be accorded special treatment. Both extreme alternatives would appear to be technically feasible. Third country vehicle manufacturers would appear to be selling in Canada at below fair market prices and could be vulnerable to a form of anti-dumping action. North American vehicle manufacturers observe the ratio and CVA provisions of the Automotive Agreement and would presumably observe even more stringent provisions in order to protect duty-free access to the Canadian market.

Either alternative could have ramifications for Canada's relations with other countries. There could be the possibility of retaliation. It is beyond the capability of the Task Force to realistically assess the potential negative impact of either course of action. This is a matter for which government must accept the responsibility. It is the feeling of some members of the Task Force that the best answer probably lies somewhere between the two extremes and probably incorporates elements of both.

The requirement to either offer incentives or to compel investment arises primarily from the fact that decisions affecting the majority of Canadian production are made outside the country and that foreign decision makers do not currently perceive Canada as being a good place to invest. To the extent

that it would be possible to have a greater degree of decision making in Canada, and to the extent that necessary improvements to the investment climate are made and any misperceptions by foreign decision makers are corrected, the need for sticks and carrots decreases. The trend towards world vehicles tends to reinforce centralized decision making. On the other hand, the inclusion of the "New Principles of International Business Conduct" in the commissioner's terms of reference tends to give some credence to the prospect that some way of achieving greater local autonomy within a centralized framework might be found.

In developing these alternatives, there was also a recognition of the particular needs of the independent parts producers. Automotive Parts Manufacturers' Association has already proposed to the government the establishment of an Automotive Investment Corporation to meet the needs of this sector which in many instances are quite different from the needs of the vehicle assemblers. The members of the Task Force who are also members of this association were strongly supportive of this proposal and frequently referred to it in the course of discussions.

LIST OF THE AUTOMOTIVE CONSULTATIVE TASK FORCE MEMBERS

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Mr. D.L. Sedgwick	President	Tridon Ltd.
Mr. R.C. Buck	President	Dominion Auto Accessories
Prof. K.R. Blowatt	B. Sc., P. Eng.	Brock University
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Mr. M. Brennan	Secretary of the Task Force	

AUTOMOTIVE TASK FORCE: REPORT OF UNITED AUTO WORKERS (UAW)

The UAW feels compelled to submit its own report with regards to the Task Force. Even though the sudden imposition of the Reisman Commission has reduced the Task Force to presenting another general analysis and once more posing the problem we feel we cannot even agree with the report on these more limited grounds. In this brief statement, our position can perhaps be stated most clearly by responding to Sections 5 (Recommendations) and 6 (Options) of the report.

There are two recommendations in this report; the first calls for an annual report to parliament. Considering the importance of the industry and the role of the Canada-U.S. Auto Pact in structuring the industry, it's quite incredible that we haven't followed the U.S. example of annual reports. Equally incredible is the fact that no adequate statistics exist for computing Canada's share of North American jobs.

An annual report is an obvious need, but it must go beyond compiling the general statistics we have had to date - we need much more basic information and this should be provided to the public as a basic democratic right. For example:

- How large is the price differential on cars and accessories? Is it justified? The UAW has argued - and presented some documentation - that the price differential is unjustified and has more than paid for all the investment by the Big Four since 1965.

- How large is the trade deficit if we include machinery imports and the outflow of royalties, dividends, and profits? How does this deficit compare on a company by company basis? If this broader notion of an auto deficit is used, the magnitude of the deficit may come close to being doubled.

- What is the level of Canadian value-added in each of the auto majors? What are the investment plans of the corporations to raise this to match our share of the North American market? At present, for every dollar of car sales in Canada, there is only about 70¢ of Canadian production.

- How many layoffs and dislocations of workers take place annually? Who bears the costs of these layoffs?

- Are the corporations training new apprentices? In general, the auto majors prefer to let the smaller companies develop skilled tradesmen and then they pirate them away (i.e. rather than train their own).

- We know there is virtually no Canadian research and development done within the Big Four, but what is the level and quality of research and development within the smaller companies?

The second recommendation of the report refers to improving the "investment climate" and removing "impediments to investment". Elsewhere in the paper these so-called impediments are not documented but rather listed as "conceptions" held by American investors. We are in total disagreement with the unsubstantiated statements in 4.2 (page 4).

The point is that any serious analysis of the industry indicates a very favourable investment climate; American "conceptions" are in fact "misconceptions" and rather than reinforcing this, the Task Force has a responsibility to state this clearly and forcibly. Instead, it seems that the corporations are prepared to leave the facts muddied and exploit the issue to gain further concessions from

governments at taxpayers' expense. In other words, we are not about to go along with a vague recommendation of "improving the investment climate" when we know that:

a) the corporations are in fact doing very well in Canada;

b) we have no guarantee, in a market economy, that tax giveaways will in fact provide any long-run advantages.

We might also add, at this point, that conspicuously absent in the recommendations are apprenticeship programs and adjustment assistance for workers (TAB).

Let's turn now to the "Options". In spite of the fact that corporations have made - and continue to make - high profits in Canada, it can correctly be pointed out that corporations aren't interested in adequate profits but the <u>best</u> profits. And Canada may very well provide an adequate return but not the best return in comparison with all the potential jurisdiction in the U.S. (and the world for that matter!). To argue however that we should therefore compete with all these others to give corporations the largest hand-out is insane - as each jurisdiction retaliates to out-do everyone else, only the corporations can win.

We therefore reject having our jobs depend on the "free" choices of corporations. Canada has a <u>right</u> to a certain share of jobs based on the market that exists here, the profits taken in Canada, and the intent of the Auto Pact. And the responsibility for enforcing this right rests with the federal government.

SG/lh
Opeiu 343
July 17, 1978

July 20, 1978

Mr. Norman Bell
Chairman
Automotive Consultative Task Force
Industry, Trade and Commerce
235 Queen Street
Ottawa, Ontario
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Dear Mr. Bell:

We have now had the opportunity to examine in detail the second draft of the Automotive Consultative Task Force Report, dated July 12, 1978.

As we indicated in our previous letter to you of June 29, we continue to have serious reservations concerning the views contained in both drafts of the report. We do not believe our views have been sufficiently accommodated in the second draft. This leaves us no choice but to disassociate ourselves from the conclusions reached by the Task Force.

We have decided not to submit a minority report on the basis that the views of the independent automotive parts industry are well known, not only to the committee but to the government officials and ministers who will eventually deal with the final report. The association has already met with Mr. Reisman and will be submitting to him before the end of August the collective views of the Canadian independent parts industry.

We have attempted, as members of the committee, to be objective, responsible and direct in our presentations. Not only have those representations been inadequately dealt with but we have found ourselves immersed in a determination on the part of the Task Force to justify a policy of industrial benefit to one sector of the industry, while the requirements of the independent parts and other sectors of the automotive industry have been ignored. The failure of the government to implement a comprehensive investment and job-creating program applicable to the entire automotive industry will result in the loss of thousands of jobs and millions of dollars of investment.

We have indicated on many occasions our desire to increase and expand investment and job-creating activities in Canada. The association's proposal for an Automotive Investment Corporation to provide loans at competitive rates of interest for tooling, research and development and capital expansion has been held in abeyance until Mr. Reisman completes his report on the automotive industry. It seems to us that this was an unnecessary delay in view of the strong support the proposed program has received from the Province of Ontario and other sources. The second draft report gives this program little mention and does not endorse it.

In the past four years, the Automotive Parts Manufacturers' Association of Canada has submitted a number of briefs and proposals outlining the elements of a fully balanced Canadian automotive and automotive parts industry. We support and endorse these positions and do not find it necessary at this point to abandon them. Of course, we do agree with some aspects of the draft report but the differences are of such magnitude that it would be impossible to overcome them under present circumstances.

The independent automotive parts industry in Canada has demonstrated its ability in the past, providing conditions are right, to create new investment and jobs on a greater scale than any other sector of the automotive industry and indeed most sectors of the Canadian economy. Since 1965, independent parts producers have invested more in Canada and created more jobs than any other segment of the industry. Taking into account the difficult economic conditions during the past three years, the independent parts industry has remained internationally competitive.

The industry continues to face the prospect of increasing trade deficits with the United States and foreign countries which exceeded $3 billion in 1977, a figure which will be undoubtedly surpassed in 1978. The effects of the Automotive Trade Agreement on present-day economic conditions in the industry have been overlooked entirely.

We support a balanced growth-oriented automotive and automotive parts industry in Canada where production of both vehicles and parts approximates consumption.

We support the "fair share" provisions of the Canada-United States Automotive Agreement which would give Canada its fair share of research and development, employment and investment based on the size of the Canadian market.

We support the creation of jobs and new investment in the automotive industry in Canada, based on the competitive nature of the industry and on the basis of incentives which (a) offset similar investment incentives in the United States, and (b) give equal opportunity to both independent parts producers, vehicle manufacturers and other sectors of the automotive industry to expand. If incentives are to be provided for investment, as we have recommended, it is our view that they must be provided on a fair and equitable basis to all sectors of the automotive industry. The cost of creating new jobs must be kept within reasonable limits and incentives should be directed to where they will provide the greatest economic benefit to Canada in the long term.

We support the concept of the Canada-United States free trade agreement provided it is monitored annually and flexible enough to adjust to the inevitable changes which take place both in the North American economy and in the marketplace.

We support the implementation of the Automotive Investment Corporation which would provide funds at reduced rates or competitive rates of interest to assist manufacturers in capital investment, tooling and research and development.

The concepts we are advancing were contained in the association's proposals to the Honourable Jean Chrétien, then Minister of Industry, Trade and Commerce, on February 17th, 1977. Our position has not changed in the interim and we continue to urge their immediate implementation.

Yours sincerely,

Frank Stronach, Chairman of the Board
Magna International Inc.

Jack Ripley, President
Canadian Fram Limited

Roel C. Buck, President
Dominion Auto Accessories Limited

C.O. Macey, Vice-President and General Manager
TRW Canada Limited, Thompson Products Division

D. Sedgwick, President
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SECTOR PROFILE

THE AUTOMOTIVE INDUSTRY IN CANADA

THE AUTOMOTIVE INDUSTRY

THE INDUSTRY WORLDWIDE

As of January 1, 1975, there were more than 300 million vehicles in use in the world. Production in 1975 was 35.6 million vehicles with 32 per cent of that total produced in North America. The Japanese, whose production was 11.5 million vehicles in 1975, are emerging as a leader in production and currently are second after the U.S.

The industry developed rapidly in North America and by 1971 the saturation level was one vehicle for every 1.8 persons. Development in Europe was particularly strong in the post World War II era and by 1971 there was one vehicle in use for every three to four persons.

In the next decade, the main market growth is likely to be focussed in the wealthier range of the developing countries. These include countries in South America, Southern and Eastern Europe. In these countries, the density of automobiles is low, the growth rate of incomes is high and populations are large. These are the ingredients for a rapidly growing market, and the investment strategies of the major companies reflect this fact.

The world industry is dominated by eight major producers with plants in many market areas. The largest of these is General Motors whose world production alone was more than 6.6 million vehicles in 1975.

THE INDUSTRY IN NORTH AMERICA

Industrial Organization

The North American industry consists of three major and several minor vehicle producers and a large number of parts suppliers ranging from the motor vehicle manufacturers themselves to small independent companies.

To understand the various elements that comprise the motor vehicle industry, it is important to obtain an overview of the structure of the industry with various other economic sectors.

The automotive industry consists of two manufacturing segments: 1) parts and components, 2) motor vehicle assembly. Each segment is dominated in varying degrees by the major motor vehicle manufacturers. These companies not only produce the majority of vehicles but they also manufacture 55 per cent* of all parts and components used in the assembly of motor vehicles. The parts and

*U.S. International Trade Commission Report to the Committee on Finance to the U.S. Senate on Investigation No. 332-76 under Section 332 of the Tariff Act of 1930 (1976).

components which these companies produce are mainly proprietary and tend to be the most capital intensive.

Appendix 1 gives a profile of each of the three major corporations in Canada, covering those aspects that are committed to the production of automotive products, and providing a picture of their position in North America.

THE INDUSTRY IN CANADA

The industry in Canada has developed primarily as an adjunct to the U.S. industry with two main sectors comprising motor vehicle assembly and automotive parts manufacturing. The automotive parts sector has, in turn, two important elements: those parts manufactured by the vehicle assemblers (captive parts) and parts produced by independent suppliers. Parts are produced for two markets, those for new vehicles (original equipment) and replacement parts for existing vehicles (aftermarket equipment). U.S. vehicle manufacturers absorb 70 per cent of Canadian vehicle production; 80 per cent of independent parts production is sold into Detroit. As a result, there is only limited interaction between vehicle manufacturers and parts suppliers in Canada. Seventy-five per cent of Canadian demand for North American vehicles is satisfied from U.S. production.

The industry in Canada is part of an integrated North American industry. Unlike the industry in the United States, the Canadian industry does not have the full range of automotive capabilities. The industry is predominantly U.S. owned and controlled and the Canadian subsidiary has generally assumed the status of a branch plant. It is normal for the parent to make investment decisions and, in many cases, to handle such functions as purchasing and labour relations on behalf of the subsidiary. In the case of vehicle manufacturers, the parent is also the principal customer of the subsidiary.

The industry in Canada is not a microcosm of U.S. industry which is roughly 20 per cent assembly, 50 per cent captive parts manufacture and 30 per cent independent parts manufacture. Proportions in Canada are roughly 30 per cent assembly, 25 per cent captive and 45 per cent independent.

Production

Prior to 1965, automotive production in Canada was oriented almost entirely to the domestic market. Because of scale limitations imposed by this restricted market, automotive production tended to be inefficient and high-cost. With the coming into effect of the Automotive Agreement the industry re-oriented production to the North American market, achieved scale economies, and became efficient and internationally competitive.

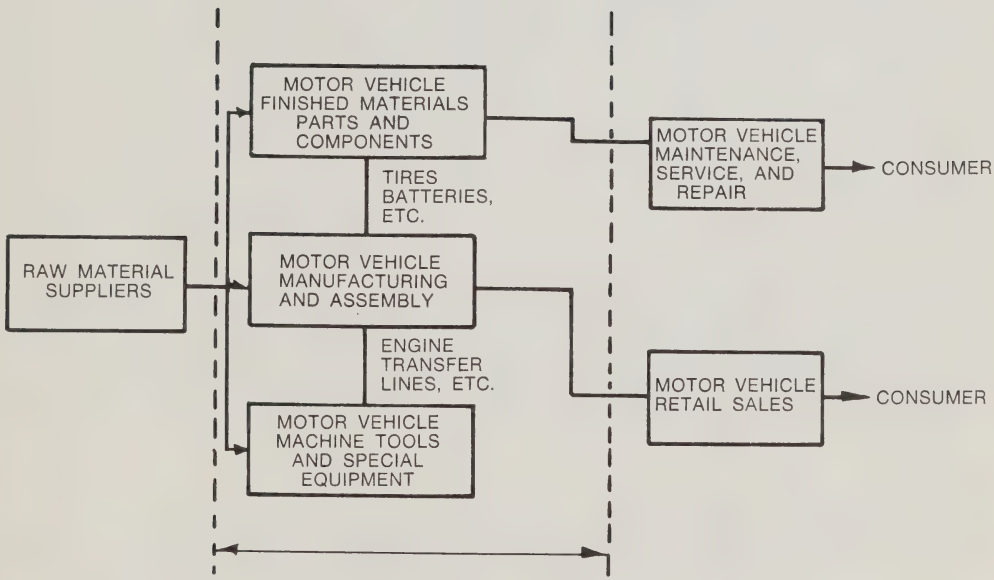
In the years immediately following the signing of the Automotive Agreement, Canada enjoyed advantages over the U.S. in wages, exchange rate and certain material costs. Canadian automotive production, as a proportion of North American production, expanded rapidly in that period, as Table I shows.

TABLE I

CANADIAN PRODUCTION AND DEMAND AS A PERCENTAGE OF NORTH AMERICAN PRODUCTION AND DEMAND

Year	*Automotive Production**	*Demand for North American Vehicles***
1965	3.8	6.8
1967	5.6	7.5
1968	7.1	7.1
1971	7.3	6.7
1973	6.7	7.5
1975	7.6	11.2
1976	7.4	8.9

**Derived from Statcan data on retail market and trade balance*
***Ward's Automotive Yearbook. Statcan.*


MOTOR VEHICLE FINISHED MATERIALS PARTS AND COMPONENTS
TIRES BATTERIES, ETC.
RAW MATERIAL SUPPLIERS
MOTOR VEHICLE MANUFACTURING AND ASSEMBLY
ENGINE TRANSFER LINES, ETC.
MOTOR VEHICLE MACHINE TOOLS AND SPECIAL EQUIPMENT
MOTOR VEHICLE MAINTENANCE, SERVICE, AND REPAIR
CONSUMER
MOTOR VEHICLE RETAIL SALES
CONSUMER

By the beginning of the 1970's Canadian advantages in automotive manufacture had been largely eroded. It would appear that since that time Canada has held a roughly constant share of North American automotive production, around 7½ per cent. Except in times of recession, production capability in Canada tends to be fully utilized. The reduced share of Canadian production in 1973 can be attributed to a large North American demand surge to which the industry in Canada was unable to fully respond. Within North America as a whole, excess capacity exists for conventional automotive fabricating. The process of reducing vehicle size which is now underway has the effect of increasing available capacity. It is unlikely that much additional capacity of a conventional nature will be required until the early 1980's.

The automotive industry in Canada grew into its present form during the 1960's when Canada was attractive to U.S. corporations as a location for labour-intensive fabrication. As a result, the pattern of automotive production in Canada reflects among other things a higher proportion of labour-intensive work (assembly and independent parts manufacture) than capital-intensive work.

TABLE II

AUTOMOTIVE PRODUCTION IN CANADA
As Percentage of North America

Year	*Assembly**	*Independent Parts**		*Captive Parts***
1965	7.8	5.5		1.2
1967	9.5	8.5		2.9
1969	11.8	10.1		3.7
1971	11.4	9.8		5.1
1973	11.1	9.2		5.5
1975	13.7	8.4		4.9
1976	12.5	—	6.6	—

**Wards Automotive Yearbook, Statcan.*
***International Trade Commission Report, Statcan.*

The Big Three, General Motors, Ford and Chrysler, account for about 95 per cent of vehicle assembly in Canada and 33 per cent of parts production. The eight largest independent parts producers account for about 17 per cent of parts production while the remaining 50 per cent is divided among some 460 firms. About 85 per cent of parts manufacture is for the original equipment market. As the dominant customers of the independent parts industry, the Big Three in Canada, and especially their parents, exert a dominant influence on automotive production in Canada.

Employment

The North American industry currently employs directly 936,000 persons. It creates additional employment of 1.7 million persons in supporting industries such as steel, rubber, other primary metal industries, etc. Service and related employment further boosts this total and it is estimated that one out of every six persons employed is working in an automotive industry-related job.

Direct employment in automotive manufacturing in Canada is 45,000 in assembly and about 60,000 in parts manufacture. Canadian employment as a proportion of North American employment is shown in Table III.

TABLE III

CANADA AS A PERCENTAGE OF NORTH AMERICA

Year	*Market**	*Employment***
1965	6.8	8.9
1967	7.5	9.4
1969	7.1	9.2
1971	6.7	10.0
1973	7.5	10.2
1975	11.2	11.3
1976	8.9	11.2

**Ward's Automotive Year Book, Statcan.*
***U.S. Bureau of Labour, Statcan.*

The higher proportion of employment in Canada can be attributed to production being more concentrated in labour-intensive activity in the U.S.

Approximately 90 per cent of automotive employment in North America is in the unskilled and semi-skilled categories.

TABLE IV

DISTRIBUTION OF EMPLOYMENT (PERCENTAGE)

	Vehicle Assembly		*Parts Manufacture*	
	Canada	*U.S.*	*Canada*	*U.S.*
Non-skilled	73	49	51	33
Semi-skilled	23	42	34	57
Skilled	4	9	15	10

The low level of skilled workers employed in Canada on vehicle assembly can be attributed to tool and die making being concentrated in the U.S. The higher level of skilled workers employed in Canada on parts manufacture could be attributed to a greater proportion of Canadian production being in specialized short-run items with the resultant need for more frequent machine re-set.

Automotive manufacturing and particularly parts production was traditionally concentrated in the Detroit area. Automotive employment in Canada is predominantly in southern Ontario.

TABLE V

DISTRIBUTION OF EMPLOYMENT IN CANADA BY REGION

	Per Cent Employment	
Region	*Assembly*	*Parts*
West	8.6	1.7
Ontario	83.0	96.0
Quebec	8.0	2.1
Maritimes	0.4	0.2

Average earnings (1976) in vehicle assembly were $307.95 per week and in parts manufacture $282.80 per week compared with $246.22 in manufacturing industry generally.

The United Auto Workers Union (UAW) is the major union in the automotive industry. Insofar as the vehicle manufacturers are concerned, the UAW has won nominal parity of conditions in Canada and the U.S. Major issues affecting both countries are generally sorted out in the U.S. and thus labour/management relations have been relatively good in Canada. As far as the independent parts producers are concerned, there was a rash of strikes in 1973 which led to the impression then in Detroit that Canada was an unreliable source of supply. The labour relations front has been relatively quiet in the past three years.

Comparative Canadian-U.S. earnings for selected years between 1965 and 1975 are shown in Table VI.

TABLE VI

CANADIAN EARNINGS AS PERCENTAGE U.S.

Year	*Assembly*	*Production Parts*
1965	77	75
1967	79	73
1969	82	73
1971	90	86*
1973	96	87*
1974	98	90
1975	94	91

Source: Canadian Imperial Bank of Commerce release.

**Reflects the relatively lower level of captive parts production where nominal Canada/U.S. wage parity exists.*

Technology

As a result of increased government requirements regarding environmental, safety and fuel economy standards, the North American automotive industry is in a period of unprecedented technological change. Certain existing capabilities will be rendered obsolete. It has become necessary to manufacture new products using high strength, low alloy steel, aluminum and plastic to reduce vehicle weight and improve fuel economy. The development and implementation of new types of propulsion systems also is on the horizon.

The industry in Canada has had only minimal participation in the process of new technology development. The research and engineering departments of the Big Three in the United States, work with the supplier industry to derive solutions to problems, thus diffusing technological innovations. Very few Canadian companies (subsidiaries or indigenous firms) have elected to participate. The labour-intensive, conventional fabricating nature of the parts industry in Canada leaves this segment of the industry particularly vulnerable to technological change.

Investment

Investment in the automotive industry in Canada for new plant and equipment (special tooling, repair, etc., excluded) averaged $159.4 million per annum between 1966 and 1970 and $142.8 million between 1971 and 1975.

Table VII gives some comparative data in Canada and the U.S. on levels of investment. While the data is incomplete it does show two things. First, the level of investment in Canadian vehicle assembly has remained relatively stable since 1969. Second, the level of investment in parts manufacture is trending downwards.

TABLE VII

NEW INVESTMENT AS PERCENTAGE SHIPMENTS

	Vehicle Assembly		*Parts Manufacture*	
Year	*Canada**	*U.S.***	*Canada**	*U.S.***
1965	4.1	NA	14.2	NA
1967	3.0	1.0	7.9	3.1
1969	1.1	1.2	6.9	2.9
1971	0.7	0.9	4.3	1.9
1973	1.2	NA	3.4	NA
1975	1.1	NA	2.8	NA
1976	0.9	NA	1.9	NA

**SC 31-001.*
***U.S. Bureau of the Census.*

In the period to 1971, the Canadian share of North American automotive production was steadily increasing. Since that time the share has remained relatively constant. The pattern of investment in Canada, as shown in Table VII reflects this situation.

When the Automotive Agreement came into effect, the vehicle manufacturers made commitments to achieve growth in Canadian value added of about 60 per cent of growth in the value of Canadian automotive sales. In recent years, some vehicle manufacturers have been operating at close to the minimum levels of growth and existence of the commitments undoubtedly has contributed to their investment performance.

Independent parts producers are not restricted as to location (Canada/or U.S.) under the terms of the Automotive Agreement and have no direct obligations similar to those of the vehicle manufacturers. They have duty-free access to both Canada and the United States for their original equipment products and can invest in either Canada or the U.S.

The major U.S. vehicle manufacturers are planning substantial investments over the next four years. These investments are related to environmental and energy-conservation developments and not to capacity expansion. The bulk of the funds will be devoted to tooling for new, smaller wheel-base vehicles. Some will be devoted to the production of new products. There is a possibility that some of this latter type of investment could be in Canada. To date, all investment in Canada has been out of Canadian earnings.

Profitability

Since the years immediately following signing of the Automotive Agreement, the ability of the Canadian corporations to expand has largely been determined by the cash flow of Canadian operations. The Canadian vehicle manufacturers, although generally more profitable than their parents in terms of return on assets, lack the backward integration of their parents and hence are at a cash flow disadvantage. Comparative data for the years 1970-75 for the Big Three plus American Motors in Canada versus the U.S. shows net income and depreciation as a per cent of sales to be lower in Canada.

TABLE VIII

NET INCOME AND DEPRECIATION AS PERCENTAGE OF SALES

	Canada	*United States*
Net Income	2.7	3.6
Depreciation	1.0	2.5

Market

In 1976, sales of North American motor vehicles were 1.1 million units in Canada and 11.7 million units in the United States. Based on North American standards of living, increases in vehicles sales correlate well with increases in the number of employed persons and with growth of the economy. Over the past decade, Canada has experienced the post-war baby boom with its impact on the labour force and a generally higher economic growth than has the United States. As a result, vehicle sales in the period 1965-1976 increased at an average rate of 3.7 per cent in the U.S. and 5.4 per cent in Canada. Consequently, the Canadian share of the overall North American vehicle market has increased from 7.1 per cent in 1965 to 8.9 per cent in 1976.

The higher growth rate of vehicle demand in Canada is expected to persist for a few years more. Industry experts expect that, under normal circumstances, the U.S. passenger car market will sustain a growth rate of 2.5 per cent per annum through 1985. Projections for Canada are for average growth rates of 6 per cent in the period 1976-1980 and for 4 per cent in the period 1980-1985. By 1985, growth rates in the two markets should be approaching one another. Commercial vehicle demand growth is projected to be similar in both countries. These projections would indicate that the Canadian share of the North American automotive market should be about 9.8 per cent in 1980 and 10.4 per cent in 1985.

Traditionally, Canada has tended to follow the United States very closely in the fluctuation of business activities (i.e., business cycles of the two countries used to be in-phase). Automobile demands in the two countries generally fluctuate in response to overall economic conditions. The energy crisis in 1973 and 1974 had more profound effect on the United States economy than on the Canadian economy. Between 1974 and 1975, while the general economic conditions and demand for automobiles in the United States were in a particularly depressed state, the economy and automobile market in Canada remained buoyant. Consequently, there was in 1974 and 1975 a relative increase in Canadian imports of U.S.-made motor vehicles and a decrease in Canadian exports of automotive parts, most of which were destined for assembly in U.S. motor vehicles.

TABLE IX

DEMAND FOR NORTH AMERICAN AND OFFSHORE VEHICLES

	Candian Demand for North American Vehicle	*Offshore Penetration Automobile Market*	
Year	*Per Cent NA*	*United States*	*Canada*
		(percentage)	
1965	6.8	6.1	11.1
1967	7.5	9.3	10.7
1969	7.1	11.2	16.5
1971	6.7	17.8	24.4
1973	7.5	15.1	19.8
1975	11.2	22.2	13.8
1976	8.9	14.9	15.7

Canadian demand for North American-produced vehicles as a percentage of North American demand is influenced not only by differing economic conditions in the two countries but by differing propensities for offshore-produced vehicles.

Industry opinion is that third country import penetration for the next decade can be assumed to be 15 per cent in the passenger car market and approximately 5 per cent in the commercial vehicle market.

THE AUTOMOTIVE AGREEMENT

The original equipment segment of the industry (vehicle assembly and original equipment parts production) operates under the Canada/United States Automotive Products Agreement of 1965. The Agreement provides for the duty-free entry into the U.S. of Canadian produced motor vehicles and original equipment (OE) parts providing they contain 50 per cent North American content. Canada allows qualified motor vehicle manufacturers to import motor vehicles and OE parts, duty-free, from any British Preferential or Most Favoured Nation country providing they meet some basic conditions of vehicle production in Canada relative to the size of the Canadian market. Motor vehicle parts may be imported duty-free for the manufacture in Canada of motor vehicles.

Aftermarket parts are generally subject to duty both in Canada and the United States and such parts are not covered by the terms and conditions of the Automotive Agreement.

In addition to basic requirements under the Automotive Agreement, the Big Three have made commitments to achieve production growth in Canada (by in-house manufacture or purchasing) of 60 per cent of Canadian market growth in automobiles and 50 per cent in commercial vehicles. Some of the Big Three are close to minimum commitment levels in relation to production growth.

The requirements on vehicle manufacturers in the Agreement and their commitments do not guarantee a trade balance with the United States. There are no requirements in the Agreement on independent parts manufacturers re production levels in Canada.

Impact on Production, Sales and Employment

Performance of the automotive industry in Canada should be viewed in the light of the objectives of the Automotive Agreement, Article 1:

Article 1

The Governments of the United States and Canada, pursuant to the above principles, shall seek the early achievement of the following objectives:

(a) The creation of a broader market for automotive products within which the full benefits of specialization and large-scale production can be achieved;

(b) The liberalization of United States and Canadian automotive trade in respect of tariff barriers and other factors tending to impede it, with a view to enabling the industries of both countries to participate on a fair and equitable basis in the expanding total market of the two countries;

TABLE X

AUTOMOTIVE PRODUCTION AND EMPLOYMENT IN CANADA

Year	*Production Vehicles*	*Production Parts*	*Employment*
	(units)	*(constant$)* (millions$)*	*(thousands)***
1965	855,476	774	81.9
1967	947,255	912	84.1
1969	1,352,900	1,308	92.1
1971	1,373,699	1,539	93.4
1973	1,575,856	2,009	108.5
1975	1,424,006	2,011	99.0
1976	1,641,577	2,500	106.8

**Source SC31-001 Deflator: Price Index of New Automobiles*
***Statcan*

(c) The development of conditions in which market forces may operate effectively to attain the most economic pattern of investment, production and trade. It shall be the policy of each Government to avoid actions which would frustrate the achievement of these objectives.

In absolute terms, the trend of production and employment in Canada has been upward since the Automotive Agreement (see Table X).

In terms of percentage of North American production and employment, Canada has benefited from the Automotive Agreement.

TABLE XI

AUTOMOTIVE MARKET, PRODUCTION AND TRADE BALANCE

Year	*Market North American Vehicles**	*Production***	*Trade Balance****
	Per Cent NA	*Per Cent NA*	*$ million*
1965	6.8	3.8	− 705
1967	7.5	5.6	− 517
1969	7.1	7.1	− 58
1971	6.7	7.3	+ 226
1973	7.5	6.7	− 414
1975	11.2	7.6	−1,800
1976	8.9	7.4	−1,050

**Ward's Automotive Yearbook*
***Derived from U.S. Bureau of Census and Statcan*
****Statcan*

Canadian production growth appears to be in step with the growth of the U.S. market. However, Canadian automotive demand has grown more strongly than U.S. demand and, as a result, there is a long-term trend of deterioration in the automotive trade balance with the United States. This long-term trend was temporarily obscured by the U.S. recession of 1974-75. Stronger demand growth in Canada than in the United States is expected to persist until about 1985. If Canada retains its share of North American production to that time the indications are that the automotive trade deficit with the United States would be about $2.4 billion (1976 dollars) in 1985.

TABLE XII

AUTOMOTIVE MARKET, PRODUCTION AND EMPLOYMENT

		*Production***			*Employment****
Year	*Market**	*Vehicles*	*Independent Parts*	*Captive Parts*	*All*
1965	6.8	7.8	5.5	1.2	8.9
1967	7.5	9.5	8.5	2.9	9.4
1969	7.1	11.8	10.1	3.7	9.2
1971	6.7	11.4	9.8	5.1	10.0
1973	7.5	11.1	9.2	5.5	10.2
1975	11.2	13.7	8.4	4.9	11.3
1976	8.9	12.5	— 6.6 —		11.2

**Ward's Automotive Year Book, Statcan.*
***International Trade Commission Report, Statcan*
****U.S. Bureau of Labour, Statcan*

Canada's relatively larger share of North American automotive employment, shown in Table XII, is due to the emphasis in Canada on vehicle assembly and other labour-intensive aspects of the industry. This labour-intensive aspect of industry is low-wage areas and from technological change.

Investment, Pricing and the MTN

Under the Automotive Agreement and the associated "letters of commitment", vehicle manufacturers are required to achieve specified levels of vehicle assembly in Canada relative to vehicle sales and Canadian Value Added (CVA) relative to value of sales in Canada. CVA can be achieved either through purchasing in Canada or through in-house production (including assembly). Should the companies work closely to the minimum levels of growth specified in their letters of commitment these levels of growth (60 per cent automobiles, 50 per cent commercial vehicles) will assure retention of the present Canadian share of North American production into the early 1980's. By 1985, when Canadian market growth will more nearly approach North American average, simply honouring minimum levels of commitment will result in a declining Canadian share of North American production.

In the years immediately following signing of the Automotive Agreement, vehicle manufacturers in Canada were able to rely heavily on parent purchases from Canadian independent parts manufacturers to enable them to honour growth commitments. More recently, with the loss of significant Canadian cost-advantage, vehicle manufacturers are becoming increasingly dependent on their own investment to meet these commitments.

Vehicle manufacturer investment decisions are made in the United States in the context of the overall needs of the corporations. Each corporation has a complete range of conventional fabricating facilities in the United States which, according to the industry, can be expanded at less cost than the erection of new facilities in either Canada or the United States. The absence of (particularly captive parts) plants that can be expanded militates against Canada obtaining other than a minimal share of investment in conventional production. The industry indicates that higher construction and associated costs, and the absence of comparable state/municipal incentives, militates against Canada attracting investment in new product facilities. The present exchange rate, should it continue, could attract further vehicle assembly into Canada when additional capacity is required.

There is little incentive to managements of the Big Three to expand investment above the levels necessary to meet minimum growth and ratio requirements. Most of their automotive production is sold to parents at transfer prices which result in minimal profitability of production operations. The majority of profit is generated from sales to the Canadian public of (largely present-produced) vehicles. Vehicle manufacturers are to a large degree wholesalers who are required to achieve a certain level of production as a condition of carrying-on their businesses.

All investment by vehicle manufacturers in Canada to date has been out of retained Canadian earnings. The level of these earnings and hence the ability to make investments is a function of costs and pricing. Within the industry General Motors is the price leader. It sets prices in order to generate a target level of return on investment. Other vehicle manufacturers tend to price against General Motors and must accept the resultant rate of return. General Motors has the major share (50 per cent) of the Canadian market for North American vehicles.

Automotive prices are higher in Canada than in the United States. The companies attribute this in part to higher costs of imported materials, warranties, advertising (two languages) and distribution. It also can be attributed to a lower propensity of Canadians to buy high-profit options, e.g., air conditioners, and hence the necessity to make more profit from the base vehicle. The Canada/U.S. price differential has, however, narrowed through the years. On the basis of a par dollar the differential for automobiles has been:

PER CENT

1965	1967	1969	1971	1973	1975	1976
16	12	11.8	10.3	9.6	6.5	6.5

The indications are that at historic levels of profitability vehicle manufacturers in Canada can generate adequate funds to honour minimum growth commitments.

The United States Department of the Treasury has extracted commitments from the parents of the Canadian Big Three to progressively reduce the vehicle price differential between Canada and the United States. This could lead to a reduction in the earning capability of the Canadian vehicle manufacturers .

The incentive to the vehicle manufacturers to meet growth commitments is duty free importation of automotive products. At present levels of duty no company can afford to pay duty on significant

importations and still price competitively to maintain market share. A reduction in the tariff on motor vehicles would, a) affect the competitive relationship between North American vehicle manufacturers and off-shore manufacturers; b) reduce the current incentive to North American vehicle manufacturers to operate under the terms of the Automotive Agreement; and c) reduce the incentive provided by the Automobile Components Remission Order to non-North American vehicle manufacturers to source automotive parts and components in Canada. This would compound the impact of the possibility of the companies only meeting the minimum levels of their growth commitments.

Implications for the Automotive Agreement

The Automotive Agreement has benefited both Canada and the United States. It has worked to integrate the Canadian and U.S. automotive industries with the result that it has been possible to achieve increased specialization and longer production runs in Canada. Decisions by Detroit respecting the divisions of production between Canadian and U.S. sources have been influenced importantly by the Agreement's safeguard provisions relating to ratio of production to sales and Canadian value added. The motor vehicle manufacturers have tended to meet these commitments through assembly. Since the signing of the Agreement, Canada has had a surplus in vehicle trade. The deficit in the parts sector is related directly to the motor vehicle manufacturers producing relatively more of their captive parts in the U.S. rather than in Canada. As stated earlier, new environmental and safety standards and fuel conservation requirements call for substantial changes in the North American vehicle and this will require considerable new investment between now and 1980. The indications are that a relatively large part of this new investment will take place in the U.S.

SUMMARY

Industry Performance

The automotive industry in Canada pays high wages and is one of the most efficient users of labour and capital in combination. It is profitable, internationally competitive, working at near-capacity and growing with its market. It is not an industry in trouble.

The Canadian industry is primarily a supplier industry to the U.S. vehicle manufacturers. Since reaching maturity about 1970, production in Canada has grown at about the rate of U.S. vehicle manufacturers sales.

In recent years Canadian automotive demand has grown at approximately twice the rate of United States demand. Divergent rates of growth of automotive production and consumption in Canada have resulted in a long-term trend of deterioration in the automotive trade balance with the United States.

The higher growth rate of demand in Canada than in the United States is expected to persist into the mid-1980's at which time Canadian growth will more nearly approach North American growth. If production in Canada continues to increase at the North American growth rate the trade deficit will be $2.4 billion (1976 dollars) by 1985.

Compared with the United States industry there is more labour-intensive vehicle assembly and independent parts manufacture in Canada and less capital-intensive captive parts manufacture. The labour-intensive activity, particularly independent parts manufacture, could be vulnerable to low-wage competition.

The North American automotive industry is in a period of unprecedented technological change as it adjusts to more stringent energy conservation, environmental protection and safety standards. There is very little Canadian participation in this change process. As a result, growth opportunities are being missed and there is the distinct possibility of technological obsolescence, particularly in independent parts manufacturing.

Investment

The automotive industry in Canada is working at close to peak capacity. Growth of output is dependent on further capital investment. The industry is predominantly foreign-owned and controlled and investment decisions are made, almost without exception, by parent U.S. corporations and this tends to impart a domestic (U.S.) bias to otherwise economic decisions.

The industry, North America wide, has entered a period of unprecedented technological change. Whole plants will require to be re-equipped and re-tooled at least once, and sometimes twice, during

the next eight years. The financial resources of the vehicle manufacturers will be strained to the limit to keep abreast of change. The reduction in size of vehicles will create additional capacity within the industry. There will be little requirement for expanded production and few resources available to create it.

Some plants will be rendered entirely obsolete by technological change, i.e., a change from metal to plastics. The old plant may not be suitable for the new product. The original producer could decide that the new product is not a suitable one to add to the corporate product line. New plants and new producers will be required to compensate for technological obsolescence. It is in this field that Canada's principal opportunities for expanded automotive production must lie.

Investment by both vehicle manufacturers and independent parts producers in Canada dropped sharply in the early 1970's when Canada ceased to have significant cost advantage as a location for automotive manufacturing. Much vehicle manufacturer investment since that time would appear to have been occasioned by the existence of commitments to achieve specified ratios of vehicle production and a growth of Canadian value added in production/purchasing equivalent to about 60 per cent of Canadian market growth.

Unlike the vehicle manufacturers, the independent parts producers have no Canadian production requirements to meet. They are free to locate production in Canada or in the United States as they wish. The mid-South of the United States now has attractions that Canada possessed in 1965; low wages and a stable non-union labour force. While these advantages are unlikely to attract much automotive work out of Canada, they will weigh heavily in considerations concerning location of new facilities or re-equipment of obsolete facilities.

All recent investments by vehicle manufacturers in Canada have been financed out of Canadian cash flow. The Big Three have entered a period in which investment in plant upgrading alone will far exceed previous levels of investment in upgrading and expansion combined. The extent to which cash flow will be consumed by upgrading varies from manufacturer to manufacturer. In general, there should be adequate reserves to invest to meet minimum levels of commitments. Recourse to external sources of funding probably would be required to finance a faster rate of growth or to compensate for a higher-than-anticipated erosion of independent parts production. The cash squeeze in which the U.S. vehicle manufacturers are caught makes it most unlikely that the external sources of funding will be the parent corporations. Vehicle manufacturers claim that any move to further reduce the price differential between Canadian and U.S. vehicles could jeopardize their profitability and hence their ability to finance future expansion.

The current Canadian tariff on automobiles (15 per cent ad valorem) is an important incentive to North American vehicle manufacturers to continue to operate under the Automotive Agreement in order to obtain duty free access to the Canadian market. Accordingly, the results of the multilateral trade negotiations could affect, in a very direct way, the operation of the Automotive Agreement.

Significant Issues

The absence of significant Canadian advantage vis-à-vis the United States in automotive manufacturing, the pattern of industry ownership and control and the predominant orientation of the industry to the U.S. market combine with the level of vehicle manufacturer commitments under the Automotive Agreement to impart a rate of growth to the automotive industry in Canada roughly approximating the rate of growth of the North American market. Over the next several years Canadian automotive demand growth will exceed North American demand growth. There will therefore be a trend of long-term deterioration in the automotive trade balance with the United States. A deficit of $2.4 billion (1976 dollars) is projected for 1985 if Canadian production continues to grow at North American average rate.

The provisions of the Automotive Agreement have slanted vehicle manufacturer investment in favour of labour-intensive vehicle assembly. Historical wage advantage, now largely eroded, has resulted in Canadian parts manufacture being concentrated in labour-intensive production vulnerable to developing world competition. Compared with the United States industry there are deficiencies in capital-intensive parts manufacturing (particularly captive parts) and in the higher-technology activities. Concentration of activity in the labour intensive areas has resulted in Canada having a greater share of North American employment than its market share. Achievement of a better balance of labour-intensive and capital-intensive work and of conventional fabricating and higher technology work could be to the advantage of the country.

APPENDIX I

General Motors of Canada Ltd.

General Motors operates two car assembly plants at Oshawa, one for intermediate and one for family size Chevrolet and Pontiac models. In addition, a truck assembly plant at the same location produces Chevrolet and GMC light models. At the Scarborough plant, GM assembles Chevrolet and GMC vans, and at the Ste. Thérèse plant compacts and subcompacts. Urban buses are being produced at London and Montreal. There are parts plants in Windsor, St. Catharines and Scarborough producing such components as transmissions, axles, trim and engines.

Total sales revenue for the company exceeds $4 billion and in 1976 over 370,000 cars were sold accounting for 47 per cent of the market for North American cars in Canada. In addition 146,000 trucks were sold accounting for 45 per cent of North American truck market in Canada. Employment has increased from the depressed levels of 1975 and in September of 1976 there were approximately 36,000 salaried and hourly employees in the corporation.

The company has spent more than $110 million in facility expansion and reorganization to meet increasing demand in 1976 and spending is expected to continue at a higher rate in 1977. Expansions are currently underway or are being planned in the Oshawa truck plant, the Scarborough van plant and the Chevrolet car plant in Oshawa. In addition, the foundry in St. Catharines is being modernized to increase capacity.

The President of General Motors of Canada Ltd. is one of the group vice-presidents of the Corporation who are part of a planning group for the North American operations.

Ford Motor Company of Canada Ltd.

Ford assembles small cars at its St. Thomas plant and standard cars at the Oakville plant. Light and medium conventional trucks as well as bus chassis are assembled in the Ontario truck plant in Oakville. The company also has an automotive glass-fabricating plant in Niagara Falls, casting and engine plants in Windsor and a radio plant in Toronto. Ford Motor Company also contracts with Livingston industries at Tillsonburg, Ontario, to produce C.K.D. (completely knocked down) vehicles for shipment to affiliated overseas companies.

Ford Motor Company of Canada has wholly-owned subsidiaries in Australia, South Africa, New Zealand and Singapore which assemble and distribute Ford products. The President of Ford Canada, within the Ford Corporation, reports to the Vice-President of sales, Ford North American automotive operations.

The Canadian sales revenue exceeds $3 billion and in 1976, 182,000 cars were sold accounting for 23 per cent of the Canadian market for North American cars and 109,000 trucks were sold representing 33 per cent of the truck market. Employment in 1975 was 14,200 and in 1976 reverted to more normal levels of 16,000. Employment levels should increase in 1977 with $70 million investment in van assembly at the plant in Oakville and a $30 million expansion of the St. Thomas plant.

Chrysler Canada Ltd.

Chrysler operates one car assembly plant and two truck plants in Windsor. Chrysler Canada is the sole source of the Cordoba model automobile. In addition, Chrysler carries on automotive component production activities at various locations in Ontario — manufacture of engines and springs at Windsor, aluminum casting at Etobicoke, and cushion and back cover sets at the trim plant in Ajax.

The President of Chrysler Canada, within the parent corporate structure, was elected a vice-president in 1976. Revenue of Chrysler Canada exceeds $2.4 billion; car sales in 1976 were 203,000 accounting for 25 per cent of the Canadian market for North American cars and truck sales were 50,000 representing 15 per cent of the market. Employment in 1975 averaged 16,000 and with the market pick-up in the U.S., further increases should have been made possible in 1976. The company has undertaken a $40 million expansion program at its engine and truck assembly plants in Windsor and this will be completed by mid-1978.

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